

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Periodic Reporting
(Proposal Four)

Docket No. RM2018-7

PUBLIC REPRESENTATIVE COMMENTS

(July 25, 2018)

I. INTRODUCTION

The Public Representative hereby provides comments in response to Commission Order No. 4685¹. In that Order, the Commission established Docket No. RM2018-7 to receive comments from interested persons, including the undersigned Public Representative, that address the Postal Service's petition to change analytical principles related to period reporting.² The Postal Service filed the Petition pursuant to 39 C.F.R. § 3050.11. It seeks review of the costing methodology for the treatment of debit card expenses. Petition at 1. The Postal Service provided additional information in its responses to Chairman Information Requests No. 1.³

II. SUMMARY OF PROPOSAL FOUR

Proposal Four seeks to change the method of assignment of debit card fees in the Retail Credit Card Fees component (Component No. 126) in Cost Segment Thirteen. Petition at 1. Currently, The Postal Service treats credit and debit card fee expenses as fully volume variable, and assigns those expenses to products in the same

¹ Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Four), June 28, 2018 (Order No. 4685).

² Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), June 25, 2018 (Petition).

³ Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 1, July 20, 2018.

proportions as the Postal Service revenue realized from aggregate credit and debit card transactions.⁴

During the preparation of the 2017 ACR, the Postal Service recognized two flaws in this methodology. The first flaw was that it assigned aggregate card fees using distribution factors calculated from the total of both credit card and debit card fees, which assumes similar transactions for credit cards and debit cards. According to the Postal Service, this is not true for all products. Petition at 1. For example, Priority Mail generates more revenue from credit card expenditures than debit cards. *Id.* The result of this assumption was a misallocation of fees among all products. *Id.*

The second flaw was the distribution factors did not fully align with actual incurrence of fee expenses. *Id.* at 2. One example is Money Orders: the Postal Service used only the revenue from the Special Service Fee charged to the customer for distribution purposes. However, the amount the Postal Service pays to the card provider is based on the entire transaction amount. *Id.* The result is an understated amount of card fees being assigned to Money Orders. *Id.*

To address both issues, the Postal Service introduced two refinements in its 2017 ACR filing. First, credit and debit card fees were segregated to develop different sets of distribution factors for debit and credit card fees. Petition at 2. Second, distribution factors for debit cards used the aggregate face value of Money Orders purchased with debit cards in conjunction with the revenue from all other products. *Id.*

During the FY 2017 Annual Compliance Determination, in a supplemental response to a Chairman's Information Request⁵, the Postal Service produced a model in order to account for the recognized major components of debit card fees. Petition at 2. In the FY 2017 ACD, the Commission directed the Postal Service to continue investigating the issues and provide an update within 90 days after issuance of the ACD. *Id.* at 4. Proposal Four seeks to address this directive by disaggregating debit card fee expenses into two cost pools using an approach that more closely aligns the fee expense distribution with how the fees are incurred.

⁴ Order No. 2350 (February 9, 2015). In Docket No. RM2015-4 the Commission approved the current methodology used in the FY 2014, FY 2015, and FY 2016 ACR.

⁵ Docket No. ACR2017, Supplemental Response of the United States Postal service to Question 1.b of Chairman's Information Request No. 2, February 23, 2018 (Response to CHIR No. 2 1.b).

III. COMMENTS

In its proposal, the Postal Service would first disaggregate the debit card fee expense (approximately \$58.6 million for FY 2017) into two cost pools: transactions and proceeds. Petition at 3. The amount in the transactions cost pool would consist of the number of regulated transactions⁶ multiplied by the 22-cent cost per transaction⁷. The Postal Service would distribute expenses in this cost pool based on the number of tenders captured from the Retail Data Mart (RDM). Petition at 4.

The proceeds cost pool would account for the remaining .05 percent of the transaction fees, along with other debit card fees, including fees for unregulated transactions. Petition at 5. Proceeds expenses would be distributed in proportion to the total revenue realized with debit cards, in the same manner as the current methodology. *Id.* at 4. The separation of cost pools and distribution factors are an improvement over the method used in prior ACRs, which assigned all costs based on the revenue realized.

To develop these cost pools, the Postal Service separates regulated transactions from unregulated transactions. The number of regulated transactions is calculated by multiplying the total number of debit card transactions by the percentage of regulated transactions (In FY 2017, 65 percent), as obtained from Treasury.⁸ In its response to the first CHIR, the Postal Service explained that its card processor works as an intermediary between the financial institution of the customer and the Postal Service to receive and record the necessary information regarding transactions, including whether they are regulated or unregulated.⁹ This processor then provides Treasury with a debit transaction report that includes the total number of transactions, amounts, transaction fees incurred by card network, and transaction group. *Id.* The Postal Service's method of obtaining this information and calculating the percentage of regulated transactions appears reasonable and represents an improvement from the methodology used in the

⁶ Debit Card transactions can be classified as either regulated or unregulated; debit card issuers with assets greater than or equal to \$10 billion are regulated by the Federal Reserve while those with assets under the \$10 billion are exempt (unregulated). Petition at 5.

⁷ In 2011, the Federal Reserve implemented a rule that limited debit card fees to 21 cents per transaction plus .05 percent of the transaction and one additional cent for fraud protection. Petition at 5.

⁸ Petition, Excel file "Prop.4.Debit.Card.Attachment.xlsx," tabs "Doc" and "Inputs."

⁹ Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 1. July 20, 2018.

FY 2017 ACD which did not account for the differences between regulated and unregulated transactions.

The Petition includes a table illustrating the cost impacts of Proposal Four. Petition at 7-8. The table compares debit card expense distribution under the current methodology and the distributions under Proposal Four. *Id.* at 7. The cost impacts appear minimal. The most significant change is to Money Orders, which increased in cost coverage under the proposed methodology from 97 percent to 107 percent. *Id.* at 7. This is because Money Orders have a higher revenue per transaction relative to other products. *Id.* at 7. The previous method assigned fee expenses based only on the share of revenue per transaction, resulting in an overstatement of expenses assigned to Money Orders. The new method distinguishes between the per-transaction and residual component for regulated transactions, resulting in a more accurate calculation of costs assigned to Money Orders.

The Public Representative agrees with the Postal Service that the proposed methodology should more accurately calculate and assign debit card fee expenses. It properly disaggregates debit card and credit card fee expenses and distributes debit card fees more accurately than the current methodology.

IV. CONCLUSION

The Public Representative supports Proposal Four and recommends its approval. The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

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